No. 14349.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE R. CARR,

Appellant,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Appellees.

APPELLEES' BRIEF.

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Preliminary Statement.

Appellee Beverly Hills Corporation is the Corporation of which appellant was and is a stockholder and allegedly upon whose behalf plaintiff-appellant filed his Complaint [R. 3, 265]. The individual appellees Maynard Brandsma, Francis E. Browne, Robert W. Langley, and Harry F. Dietrich formerly were members of the Board of Directors of said Corporation and appellee John F. Lordan was and is an officer and a member of the Board of Directors of said Corporation [R. 4, 266]. Appellee Ross J. Ferrar was and is an officer of said Corporation but has never been a director [R. 266]. All of the

individual appellees are doctors of medicine except appellee Ferrar, who is a registered pharmacist [R. 5, 105].

The Complaint herein alleges that the individual appellees negligently and fraudulently managed the affairs of appellee Corporation during 1951 and 1952 in several particulars and seeks a judgment against the individual appellees in favor of appellee Corporation for money damages, for an accounting and for plaintiff's attorneys' fees and costs [R. 7-26]. All these charges were specifically denied in affidavits filed in connection with the motions hereinafter mentioned [R. 90-97, 101-120, 223-241], but the details of such denials and attendant explanations will not be herein set forth or discussed because they are not relevant to the question of jurisdiction which is the sole issue involved on this appeal.

Appellee Corporation filed a motion to dismiss the complaint herein for failure to state a claim upon which relief can be granted or, in the alternative, to require plaintiff to post security pursuant to Section 834(b), California Corporations Code [R. 46]. The individual appellees made a similar motion, and in addition moved to strike the complaint as sham, false, vexatious and frivolous [R. 88]. The trial court, noting that it "probably" lacked jurisdiction over the subject matter of the action and hence jurisdiction to entertain said motions, dismissed the motions of appellees with leave to renew the same if and when it should be determined that the court had jurisdiction over the subject matter [R. 253].

Appellee Corporation and the individual appellees thereafter filed separate motions to dismiss the complaint for lack of jurisdiction over the subject matter of the action and, in the alternative, renewed their earlier motions [R.

254, 257]. After submission of briefs and oral argument, the District Court made and filed Findings of Fact and Conclusions of Law [R. 264-270] and its Judgment dismissing the action "for lack of jurisdiction over the subject matter" of the action [R. 271-272]. Thereafter appellant duly perfected the within appeal from said judgment of dismissal.

Upon motion duly made by appellees, and upon stipulation of appellant, this Court by its order on October 8, 1954, authorized all appellees to join in filing a single brief.

Jurisdictional Statement.

Appellant alleged in his complaint that the United States District Court had jurisdiction over the subject matter of the action because the amount in controversy exceeded $3000.00, exclusive of interest and costs, and the suit was between citizens of different states [R. 2-3], and it is a fact that at all times here pertinent appellant was a citizen of Illinois; appellee Corporation was duly organized under the laws of the State of California and was a citizen of that State; and all the individual appellees were citizens of the State of California [R. 265].

Appellant contends (Op. Br. p. 2) that the District Court had jurisdiction under Title 28, U. S. Code, Section 1332, since (he claims) the controversy is between citizens of different states and exceeds the jurisdictional minimum amount of $3,000.00. However, after going fully into the facts, the District Court realigned appellee Corporation with appellant as a plaintiff and hence determined that the requisite diversity of citizenship did not exist [R. 268-269].

Statement of the Case.

Inasmuch as we do not consider that appellant's statement of the case either correctly or adequately presents the facts which are pertinent to his appeal, appellees herewith present their own statement of the case as is allowed by Rule 18(3) of the Rules of this Court.

The sole issue before this Court is whether or not the District Court correctly determined that it did not have jurisdiction over the subject matter of the within action. Appellant in his Opening Brief devotes practically all of his statement of the case to a discussion of matters which relate solely to the alleged "merits" of the action but which clearly are immaterial to a determination of the jurisdictional issue now before this Court. All of appellant's charges have been denied in affidavits filed below by or on behalf of the appellees, and appellees invited and welcomed a full examination of the "merits" of plaintiff's claim in the Court below. In fact they twice sought to have the District Court determine these issues on motions to dismiss for failure to state a claim upon which relief could be granted. The trial court determined, however, that it was without jurisdiction to hear those motions to dismiss, and the case is now before this Court solely upon the jurisdictional issue. Hence, we shall confine our brief to the facts relating thereto.

Plaintiff became a stockholder in appellee Corporation in June, 1950, when he purchased 400 shares of common stock and he was such a stockholder at the date the action was commenced. His stock holding represents 1.6% of the total issued and outstanding shares of the common stock of appellee Corporation [R. 265], and his cost of the stock was $400.00 [R. 234]. No other stock-

holders of appellee Corporation joined in the prosecution of the within action [R. 2].

Appellant's son-in-law, Dr. Omar Fareed, is now and at all times mentioned in the Complaint was also a small stockholder of appellee Corporation, and was previously a partner in the Beverly Hills Clinic [R. 116, 117]. Donald A. Fareed, brother of the said Dr. Omar Fareed, was the attorney for appellee Corporation and the Beverly Hills Clinic and was secretary of the said Corporation from December 6, 1950, to December 4, 1952 [R. 116, 220, 225], and was and is a small stockholder in said Corporation [R. 226]. Donald A. Fareed supervised and advised both said Corporation and said Clinic concerning all of the alleged transactions described in the complaint herein, with the single exception of the matter described in the third cause of action of said complaint [R. 117]. Dr. Omar Fareed and Donald A. Fareed were fully informed of all material matters relating to said Corporation and said Clinic, and communicated at length with appellant concerning said matters throughout the periods described in said complaint [R. 221, 234, 235]. By a letter dated December 1, 1952, the said Donald A. Fareed was formally designated by appellant as one of his attorneys in connection with appellant's alleged charges against the individual appellees. [R. 234-235.]

The true facts respecting the transactions alleged in the complaint herein have never been concealed from any stockholder of appellee Corporation and such transactions as occurred were entered into with the full knowledge, or means of knowledge, and acquiescence of all stockholders [R. 118]. No objection to any of said transactions was ever made by any stockholder of appellee Corpora-

tion, or by anyone else, until early December of 1952, when one of appellant's counsel made certain objections and requested certain information from officers of appellee Corporation [R. 118, 122]. In connection with such requested information, all of said Corporation's books and records were promptly made available to appellant's counsel, but said attorney refused to examine or inspect said books and records. [R. 122-125.]

Between early December, 1952, and the latter part of April, 1953, counsel made available for examination and copying to appellant's counsel numerous documents and papers of appellee Corporation and the Clinic [R. 126-129, 132-134] and counsel agreed to have the firm of Haskins & Sells, certified public accountants, make a complete audit of all transactions between appellee Corporation and said Clinic [R. 129-131], which was promptly done, and a copy of said audit report was furnished to appellants' counsel on or about April 18, 1953 [R. 137-138]. Said audit report, covering the period from March 7, 1950 (the date of the first recorded transaction between said Corporation and said Clinic), until February 28, 1953, verified and supported all transactions between said Corporation and said Clinic, except for several items of minor monetary amounts [R. 138-140].

On March 25, 1953, four new members of the board of directors of appellee Corporation were elected and took office, replacing on said Board appellees Brandsma, Browne, Langley, and Dietrich [R. 90, 94, 101, 110, 134, 135]. None of said new board members was a stockholder of said Corporation or a partner of the Beverly Hills Clinic, but each was a well-known business man, to wit: Robert Denny, President of Grand Central Air-

craft Co.; Robert Clark, President of Robert H. Clark Co.; Homer Burnaby, President of Sierra Lumber Company and Vice-President of Sun Lumber Company; and Shirley Burden, partner of the firm of William A. Burden & Company and civic leader [R. 48, 51, 53, 134, 135, 182]. Appellant's counsel was promptly notified of the names of the new members of said board of directors [R. 137], and was informed in writing on March 25, 1953, that if "there are any possible corporate claims which you think should be given attention, there is now an independent Board of Directors of the Corporation which will be available to give careful consideration to any matters when submitted to you" [R. 137]. No claims of any kind have ever been made by appellant or his counsel to said new board of directors [R. 48, 51, 55, 182].

On April 30, 1953, at about noon, appellant delivered to appellee Ferrar a copy of the complaint herein, attached to which was a "demand," addressed to the board of directors of said Corporation and dated April 27, 1953, that said Corporation "join" in prosecuting the within action against the individual appellees [R. 44, 45. 98. 99]. The then counsel for said Corporation was thereupon informed by appellant's counsel that said complaint was to be filed in court that same afternoon [R. 99]. Said Corporation's counsel stated to appellant's counsel that he would call a meeting of the board of directors as soon as possible that afternoon to consider the claims of appellant, to which appellant's counsel replied that the complaint would be filed that said day "regardless of action by the Board of Directors" [R. 99, 100]. The complaint was, in fact, filed that same afternoon on April 30, 1953 [R. 140].

The hereinabove mentioned Donald A. Fareed represented the Corporation throughout the period now complained of by appellant, and the law firm of Gibson, Dunn & Crutcher did not begin representing appellee corporation until December 4, 1952 [R. 127, 142]. On May 4, 1953, as soon as the complaint and claims of appellant were brought to the attention of the new board of directors of said Corporation, and upon the suggestion of Herbert F. Sturdy of Gibson, Dunn & Crutcher that said Corporation might desire to secure new legal counsel, said new board selected and retained the law firm of Latham & Watkins to represent said Corporation herein [R. 56, 142]. Since that date Gibson, Dunn & Crutcher has not represented said Corporation, but has been retained to represent and has represented the individual appellees herein [R. 142].

The new Board of Directors of appellee Corporation immediately began, through its new counsel, a complete and independent investigation of the facts and the law involved in the claims set forth in the complaint herein [R. 56-57]. Said investigation continued through the course of four or five weeks [R. 58]. During said investigation, appellee Corporation's counsel, on June 5, 1953, made a written request upon appellant's counsel for any information appellant had to support his charges [R. 80-82]. Almost three weeks later appellant's counsel replied to said request but furnished no such information [R. 83-85]. Counsel for said Corporation immediately replied to appellant's counsel, repeating the prior request for said information, and suggesting a conference to discuss the matter [R. 86-87]. No reply having been received to this last letter, counsel for appellee Corporation tele-

phoned to appellant's counsel on June 30, 1953, and again suggested such a conference [R. 76].

A conference was finally held between attorneys for appellant and appellee Corporation on July 10, 1953 [R. 76]. Said Corporation's counsel at this conference related fully the results of its investigation of the claims of appellant and its conclusions and again requested information or proof to support said claims from appellant's counsel [R. 76, 192, 193]. Except for several matters of minor importance, appellant's counsel did not furnish or relate any of said requested information [R. 76], and has not furnished any such information to this date [R. 76, 197].

Meanwhile, the board of directors of appellee Corporation met in a special meeting on June 24, 1953, to receive and consider its counsel's written report of its investigation of the facts and the law relating to appellant's claims herein [R. 58]. After a thorough and careful analysis and discussion of each of said claims, the board of directors (except Dr. John P. Lordan, who did not participate in the discussion and did not vote) adopted a detailed resolution to the general effect that since the claims of appellant were not supported by the facts, and the prosecution of appellant's claims would not be to the best interests of said Corporation, that the appellee Corporation not join in or prosecute the action instituted by appellant but take whatever steps were necessary and possible to terminate said litigation with the least possible expense to said Corporation [R. 63-73].

Another meeting was held by the board of directors of appellee Corporation on October 15, 1953, in which there was considered and discussed matters which had occurred

in the within litigation since their prior meeting [R. 207-217]. At the conclusion of this meeting said board of directors (except Dr. Lordan, who did not participate and did not vote) adopted a detailed resolution reaffirming its prior resolution of June 24, 1954 [R. 214-217].

Four members of the board of directors of appellee Corporation (Messrs. Burnaby, Denny, Clark, and Burden) are not charged with having anything to do with the alleged transactions complained of by appellant. All of them have high reputations in Los Angeles business and civic circles [R. 54]. None of these gentlemen, except perhaps Mr. Burden, even knows all of the individual appellees [R. 48, 49, 51, 52, 54, 183]. There has been no attempt by any individual appellee, or by anyone else, to influence the present Board of Directors of appellee Corporation in the exercise of the board's judgment and discretion [R. 49, 52, 57, 58, 183].

In determining that the prosecution or maintenance of appellant's suit herein is not to the best financial interests of appellee Corporation, the present Board of Directors has acted in good faith and has exercised its independent judgment, after a full and complete investigation of the facts relating to appellant's claims herein [R. 49, 51, 52, 57, 58, 183, 184], and after unsuccessfully attempting to secure from appellant information supporting said claims [R. 76, 80-87, 197].

Appellee Corporation is now in the process of a voluntary winding up and dissolution upon the written consent of over 90% of its stockholders [R. 128]. The building, which was said Corporation's principal asset, has been sold to a third party for $1,430,000.00 for a profit of over $157,000.00 to said Corporation, and said Corpora-

tion's remaining equipment was sold to the Beverly Hills Clinic for $97,673.34 [R. 127, 128, 141]. From these sales the stockholders of said Corporation (including appellant who loaned $20,000.00) have been repaid the full amount of their loans of $727,095.00 made to the Corporation, plus interest thereon, and it is anticipated that at the close of dissolution said Corporation will return to its stockholders the full purchase price paid for their shares of stock plus a profit of about 75% of said purchase price, unless the cash remaining for distribution is dissipated in the costs and expenses of this litigation [R. 141]. Any cash recovery which appellee Corporation might obtain through appellant's efforts in this action would automatically be disbursed in cash by the dissolving corporation to its stockholders. Hence, in an endeavor to quickly terminate this obviously useless and unnecessary litigation, which no one favors except the appellant, the individual appellees, without acknowledging any liability, offered to pay to the appellant his full pro rata share (a few hundred dollars) of the full amount claimed by him for the Corporation in the complaint. Appellant refused such offer as being "unrealistic" [R. 143-144].

Appellant concedes, and the District Court found that appellant brings the within action as a derivative action in the right of and on behalf of appellee Corporation and seeks to recover a judgment in favor of said Corporation [R. 265]. Appellee Corporation is the real party in interest herein and an indispensable party [R. 265]. None of the majority of the present board of directors of appellee Corporation, to wit, Messrs. Burnaby, Clark, Denny and Burden, is or has been under the domination or control of any of the individual appellees or of any person

or persons who have been antagonistic or hostile to the financial interests of said Corporation [R. 49, 51, 52, 57, 92, 96, 103, 108, 112, 119, 183, 267, 268] and the Corporation was not at the commencement of said action and is not now incapacitated from bringing or maintaining suit upon any cause of action which may exist in its favor or from protecting its own financial interests [R. 268].

Under all of the circumstances the trial court determined that although designated as a defendant by appellant, for the purpose of determining whether the necessary diversity exists, the appellee Corporation must be realigned as a plaintiff [R. 268]. The result of such realignment was that the necessary diversity of citizenship did not exist and accordingly the court dismissed the action for lack of jurisdiction [R. 269, 272].

Summary of Argument.

Appellant's argument (Op. Br. pp. 14-35) contains numerous subdivisions, but his basic disagreement with the trial court's decision is really only two-fold:

First: Appellant claims that Finding of Fact No. 10 is erroneous. (Op. Br. pp. 32-34.) Finding No. 10 is to the effect that the defendant Corporation, for whose benefit the action is being brought by plaintiff, has *not* been under the domination of the individual defendants herein or any of them or under the control of anyone else who has been antagonistic or hostile to the financial interests of the Corporation at any time since at least as early as March 25, 1953 *(five weeks prior to the commencement of the within action),* that the Corporation was *not* at the time of the commencement of the within action incapaci-

tated from bringing or maintaining suit upon the alleged causes of action set forth in the Complaint, and that the Corporation was *not* at the time of the commencement of the action incapacitated from protecting its own financial interests. [Finding No. 10, R. 267-268.]

Second: Appellant claims that the legal theory upon which the Court dismissed the Complaint, to wit, that the appellee Corporation must be realigned as a plaintiff under the factual circumstances disclosed by the record, is erroneous. (Op. Br. pp. 15-31.)

With respect to the first issue, appellees' position is that Finding No. 10 is fully supported by the evidence, for an independent Board of Directors was in control of the corporation for more than a month before the complaint was filed; that four of the five members of said new Board are outstanding business men who are not involved in any way in the alleged wrongdoings described in the complaint; that said new Board has exercised its independent business judgment and determined that it would not serve the best interests of the Corporation to prosecute or join in appellant's action; and that the Corporation is fully able to protect its own financial interests. (Argument, Point I.)

With respect to the second issue, appellees contend that the District Court properly applied correct legal principles to realign the parties according to the true facts and then to dismiss the action for lack of diversity jurisdiction. (Argument, Point II.)

ARGUMENT.

The determination of this appeal depends primarily upon the question of whether or not appellant can overturn the trial court's Finding of Fact No. 10. Hence, we will first show the accuracy of the questioned finding, and thereafter will demonstrate the correctness of the trial court's legal conclusions from that finding, although appellant in his Opening Brief treated these subjects in the reverse order.

I.

Appellant Failed to Meet the Burden of Showing Facts Sufficient to Demonstrate the Existence of Jurisdiction, and the Trial Court's Finding No. 10 to the Effect That the Appellee Corporation Has Not Been Under the Domination of Anyone Antagonistic or Hostile to the Financial Interests of the Corporation, Nor Has It Been Incapacitated From Maintaining the Action, Was Clearly Correct.

A. Introduction.

Strangely enough, although it is clearly the heart of the trial court's decision and hence necessarily the primary hurdle which appellant must overcome on this appeal, appellant withholds his attack on Finding No. 10 until the very end of his brief, and then devotes only about two pages to that attack. (Op. Br. pp. 32-34.) A reading of those pages in conjunction with the full record before the trial court, will demonstrate beyond question the correctness of the trial court's tenth finding.

It is well settled, of course, that where jurisdiction is questioned, the party invoking that jurisdiction has the

burden of demonstrating facts from which the existence of jurisdiction may be shown.

McNutt v. General Motors Acceptance Corp. (1936), 298 U. S. 178, 56 S. Ct. 780, 80 L. Ed. 1135;

Royalty Service Corp. v. City of Los Angeles (9th Cir., 1938), 98 F. 2d 551, 554.

The record in this case shows beyond question that appellant wholly failed to meet the burden of showing facts sufficient to support jurisdiction.

B. The Complaint and the Record Fail to Show That the Corporation Was or Is Incapacitated From Suing Upon the Alleged Claims Set Forth in Plaintiff's Complaint or From Protecting Its Own Financial Interests.

Let us first examine appellant's Complaint which, incidentally, does not even allege that the appellee Corporation was under the domination of the alleged wrongdoers or in any way incapacitated to protect its own interests at the date the action was commenced.

In his Complaint, appellant affirmatively pleaded that four of the five members of the Board of Directors were replaced by new personnel on March 25, 1953 [R. 11], which was *more than five weeks prior to the commencement of the within action* on April 30, 1953. The Complaint admits that appellant has never demanded or requested that the Corporation take action against anyone to recoup the alleged losses [R. 11]. The record is devoid of any evidence whatsoever that any demand for relief was made upon the new Board, save and except the "demand" attached to the Complaint [R. 44], which was left with the business manager of the Corporation only

a few hours prior to the filing of the action. Appellant's use of this "demand" clearly shows that appellant was not acting in good faith herein for at least three reasons: (1) the "demand" was not that appellee Corporation institute or take action against the individual appellees, but merely that the Corporation "join" appellant in prosecuting the action; (2) although immediately requested by the Corporation's counsel, the attorney for appellant refused to withhold the filing of the action for even one day to enable the new Board of Directors to convene and consider the "demand," and (3) appellant knew, of course, that if the Corporation had joined with appellant as "demanded," *the very diversity upon which appellant relies would have been extinguished,* since appellee Corporation is a citizen of the same state as all of the individual appellees.

Further, the Complaint fails to allege that the new Board of Directors has acted improperly in any way, or that it refused to bring the action, or that it abused its discretion in not bringing or maintaining an action. Under controlling California authorities it is clear that because of the absence of such allegations, the Complaint wholly failed to state a claim upon which relief could be granted. (See: *Findley v. Garrett* (1952), 109 Cal. App. 2d 166; 240 P. 2d 421.) (Hearing denied by California Supreme Court.)

The evidence is overwhelming that a majority of the new Board (four out of five) was in fact entirely independent and not under the control of the individual appellees or of anyone else. Appellant has never seriously challenged this fact. In his Complaint, appellant ventures the bare conclusion that the four new Board members

"were friendly to, and partisans of the then Board of Directors" [R. 11], but appellant offered no evidence to prove even this rather mild charge. The effect, if any, of these conclusory allegations was totally destroyed by the clear-cut, unequivocal statements under oath by each of the four new Board members in which they denied that they were "friendly to" or "partisans of" the former Board, or were in any manner controlled or dominated by members of the old Board [R. 48-58, 183-184]. Although given ample opportunity [R. 264] to do so, appellant failed to challenge or rebut in any way the truthfulness of such sworn statements.

The independence of the new Board of Directors is further shown by the fact that (a) four of its five members are outstanding businessmen who had no prior business relations with appellees and who are not alleged to have been involved in any way in the alleged wrongful transactions described in the Complaint [R. 48, 51, 53, 134, 135, 183]; (b) as soon as appellant's "demand" and Complaint were brought to the attention of the new Board, it immediately retained new legal counsel and directed counsel to make a complete investigation of all the facts relating to appellant's charges [R. 56, 58]; (c) it sought unsuccessfully to get from appellant any evidence to support such charges [R. 76, 80-82, 88-89, 197]; (d) it held two special Board meetings where it received and considered thoroughly its counsel's report upon investigation of appellant's charges [R. 58-73, 207-217]; and (e) it determined in good faith, and only after all facts were exposed and studied, that it would not serve the interests of the Corporation to have the action prosecuted or maintained [R. 63-73, 208-217].

Upon these facts and the entire record, it seems clear that the trial court correctly found that for more than a month prior to the commencement of the action and at the time of the commencement of the action, the Corporation was *not* under the control of any person or persons who were antagonistic or hostile to the financial interests of the Corporation, and that the appellee Corporation likewise was *not* at the time of the commencement of the action in any way incapacitated from bringing the within suit or from otherwise protecting its own financial interests.

C. Appellant Has Failed to Support His Attack Upon the Trial Court's Findings Upon Which the Court Based Its Determination That It Lacked Jurisdiction.

Let us analyze briefly the appellant's attack on Finding No. 10.

(1) Appellant notes that one of the appellees (Dr. John P. Lordan) is still a member of the five-man Board of Directors and is President of the Corporation, and that another appellee (Ross Ferrar) is still its business manager, Secretary and Treasurer, and that all of the individual appellees were and are members of the Corporation's Executive Committee. (Op. Br. p. 32.) But just how or in what manner these facts challenge the propriety of Finding No. 10 is not shown by appellant. To the contrary, the sole and overwhelming evidence before this Court is that the present independent Board of Directors has exclusively managed the Corporation since March of 1953, and the governing body of the Corporation is, of course, its Board of Directors (Cal. Corp. Code §800).

(2) Appellant next states that the individual appellees own 42.1% of the stock of the Corporation. (Op. Br. p. 32.) We fail to see how this fact aids appellant's position, since it affirmatively shows that the individual appellees do *not* own a majority of the stock.

(3) Appellant claims that "the new directors were selected for the corporation by the individual appellees at the suggestion of the attorney for the individual appellees." (Op. Br. p. 32.) While appellant apparently intends to be critical of this method of selection, he fails to suggest any other means and we do not know any better way of obtaining a new and independent board than to have the representatives of the Corporation, and its attorneys, request leading businessmen of the city to take charge of the corporate affairs [R. 134].

(4) Appellant further states that since the new Directors were selected by the individual appellees, "it is significant to know the extent to which the new directors were acquainted with the individual appellees." (Op. Br. p. 32.) Appellant then proceeds to point out that almost none of the new Directors had any real acquaintanceship with the old Directors (Op. Br. p. 33). This fact, of course, tends to prove the independence of the new Board, and refutes the charge made in the Complaint that the new members of the Board "were friendly to, and partisans of, the then Board of Directors" [R. 11]. Appellant's change of position, no doubt, was made necessary by the clear and undisputable evidence presented below that the new members of the Board were in fact completely independent of the old members.

(5) Lastly, appellant states that the Corporation and the individual appellees were represented by the same

attorneys from December, 1952, until after the action was filed (Op. Br. p. 33). But it is clear that the law firm of Gibson, Dunn & Crutcher did not represent the Corporation or any of the appellees until December, 1952, long *after* the various acts alleged in the Complaint were supposed to have occurred, and appellant nowhere suggests that counsel who took over *after* the alleged wrongful acts did not represent it and its stockholders fully, fairly and properly at all times. The record shows that such new counsel was most receptive to every suggestion of appellant, had a special audit made for his benefit, invited appellant to submit his claims to the new Board of Directors, and cooperated in every way in trying to ascertain whether any of appellant's charges was valid. Bearing in mind that the new counsel had not represented the Corporation at the time of the occurrence of the alleged wrongful acts by the old Directors, there was no reason why they could not represent the Corporation while appellant's claim was being explored. *Nor is there the slightest suggestion that appellant ever requested the intervention of new counsel.*

We submit, therefore, that the court's finding, that at the time of the commencement of the within action, the Corporation was not under the control of anyone hostile to its financial interest and that it was able to take care of its own business affairs and to protect its own interests, was not only amply supported by the evidence, but is actually not challenged by anything in the record and was in fact the only finding which could have been made on the evidence presented below. Certainly the appellant has not shown that the finding is clearly erroneous within the meaning and intent of Rule 52(a) of the Federal Rules of Civil Procedure.

II.

Under the Circumstances Disclosed by the Record the Trial Court Properly Realigned the Appellee Corporation in Its True Position as Plaintiff, and There Then Being No Diversity, the Action Was Properly Dismissed for Lack of Jurisdiction.

A. Appellant Concedes the Correctness of the Several Underlying Rules of Law Relied Upon by the Trial Court.

Appellant concedes the basic rules of law relied upon by the trial court in dismissing his complaint, and thus has narrowed considerably the issue to be determined by this Court. For example, appellant has conceded in his Opening Brief that:

(1) "The federal courts possess only such jurisdiction as is conferred upon them by the constitution and the laws of the United States." (Op. Br. p. 12.)

(2) The test of jurisdiction "must be determined with reference to the attitude of the case at the time of the filing of the action." (Op. Br. p. 12.) In other words, jurisdiction which exists at the time of the filing of an action cannot be ousted by subsequent events any more than can jurisdiction be conferred by a factual situation which existed more than a month prior to but not at the time of the filing of the action.

(3) "In a stockholder's derivative action the stockholder is asserting a cause of action belonging to his corporation." The corporation is the "real party in interest" and "an indispensable party" and "the citizenship of the corporation must be considered in aligning the parties for the purpose of testing jurisdiction." (Op. Br. p. 16.)

(4) Where federal jurisdiction "is invoked upon the basis of diversity of citizenship, the Court is not bound by the arrangement in which the pleader has placed the parties, *but will look beyond the pleadings and arrange the parties according to the facts.*" (Op. Br. p. 12.)

B. It Is Only When the Corporation Is in "Antagonistic Hands" That the Corporation Can Properly Be Aligned as a Defendant in Determining if Diversity of Citizenship Exists.

The law on the subject of the proper alignment of parties in stockholders' derivative suits has been carefully and thoroughly discussed in the case of *Smith v. Sperling* (S. D. Cal. 1953), 117 Fed. Supp. 781. That is a decision by the same District Judge who decided the within case and little can be said to add to the law on the subject as therein expressed. In this connection it should be noted that although appellant is aware of the *Smith* case (Op. Br. pp. 15-16), *nowhere in his brief does he attack or make any attempt to differentiate or criticize that decision,* despite the fact that it expresses the views of the trial court in the within case and, on the law, represents an identical decision with this one. Hence, we respectfully refer this Court to the decision in *Smith v. Sperling, supra,* confident that it represents a full and correct statement of the law and amply supports the trial court's dismissal for lack of jurisdiction in the within action.

The main, if not the sole, difference of opinion between the parties upon the legal issues here involved, may be summarized as follows: Appellant's position is that a mere refusal to bring suit by the Board of Directors of a corporation makes the corporation so opposed to the

object sought by the plaintiff-stockholder that the corporation may be aligned as a party defendant for diversity purposes. On the other hand, it is appellees' position that to justify alignment of the corporation and the individual appellees on the same side, it must be affirmatively shown that the corporation is "in 'antagonistic hands'—*i. e.,* so dominated that it is incapacitated to act in keeping with its own financial interests." (*Smith v. Sperling, supra,* p. 801.)

In the overwhelming number of cases which have considered this problem and which have aligned the corporation as a defendant, the corporation has, in fact, been under the domination or control of, or has participated with, the officers or board of directors whose fraudulent or illegal actions the suit seeks to redress. See, for example, *Doctor v. Harrington,* 196 U. S. 579, 25 S. Ct. 355, 49 L. Ed. 606; *Venner v. Great Northern Ry.,* 209 U. S. 24, 28 S. Ct. 328, 52 L. Ed. 666; *Cutting v. Woodward* (9th Cir. 1918), 255 Fed. 633, all of which cases are cited by appellant in his Opening Brief.

Appellant relies heavily upon the "leading case" of *Doctor v. Harrington, supra.* This decision is thoroughly analyzed in *Smith v. Sperling, supra,* where it is pointed out that the court in the *Doctor* case determined the jurisdictional facts solely upon the allegations of the complaint, which included the statement that, "The board of directors of said corporation is under the absolute control and domination of the defendant John J. Harrington [who] by reason of having possession of a majority of the capital stock . . . likewise controls the action of the stockholders." (196 U. S. at p. 582, 25 S. Ct. at p. 356.) From these allegations, the court concluded that the cor-

poration should not be aligned with the plaintiffs in determining diversity jurisdiction.

However, as appellant readily concedes (Op. Br. p. 17), the true rule in determining jurisdiction based upon diversity of citizenship in this type of case is set forth in the *Removal Cases,* 100 U. S. 457, 469, 25 L. Ed. 593, 598, where the court said:

> "Under the old law the pleadings only were looked at, and the rights of the parties in respect to a removal were determined solely according to the position they occupied as plaintiffs or defendants in the suit. . . . Under the new law the mere form of the pleading may be put aside, and the parties placed on different sides of the matter in dispute *according to the facts.*" (Emphasis supplied.)

As to the other decisions relied upon by appellant, most of them are analyzed and discussed by the court in *Smith v. Sperling, supra,* and this conclusion reached (117 F. Supp. 804):

> "Only in cases where it appeared that the plaintiff-stockholder's corporation was 'in antagonistic hands,' *Koster v. (American) Lumbermens Mutual Co., supra,* 330 U. S. at page 523, 67 S. Ct. at page 831, has the Court found that 'difference or collision of interest' between stockholder and corporation as to 'the matter in controversy' *City of Dawson v. Columbia Trust Co., supra,* 197 U. S. at page 181, 25 S. Ct. at page 421, which precludes alignment of the corporation with the stockholder in determining diversity jurisdiction.
>
> "And only in cases where it appeared that the plaintiff-stockholder's corporation was 'dominated and controlled' by the alleged wrongdoers, *Koster v. (American) Lumbermens Mutual Co.,* D. C. E. D.

> N. Y. 1945, 64 F. Supp. 595, 596, and so 'made to act * * * subservient to some illegal purpose,' *Doctor v. Harrington, supra,* 196 U. S. at page 587, 25 S. Ct. at page 357, or to engage in 'the same illegal and fraudulent conduct,' *Venner v. Great Northern Ry., supra,* 209 U. S. at page 32, 28 S. Ct. at page 329, has the Court found the corporation to be 'in antagonistic hands.' "

But what is the nature of the "antagonism" which must be shown to exist in order to align the corporation as a defendant in a stockholder's derivative action? Appellant contends that a *mere refusal* of the corporation to sue makes the corporation "antagonistic" for this purpose (Op. Br. p. 27). Admittedly, such language may be found in some decisions cited by appellant, notably *Schmidt v. Esquire, Inc.* (7th Cir. 1954), 210 F. 2d 908, and *Ashwander, et al. v. Tennessee Valley Authority* (1936), 297 U. S. 288, 56 S. Ct. 466, 80 L. Ed. 688. However, an examination of these two cases will show that they are not authority for appellant's contentions. In each case the statement quoted by appellant is pure *dictum.* Thus the statement twice quoted by appellant from the *Schmidt* case (Op. Br. pp. 21-22, 27-28) is immediately followed in the opinion by the statement that it need not consider further the plaintiff's theory of alignment since the District Court had correctly ruled that under the circumstances of the case, the citizenship of the corporation was immaterial for the purpose of testing diversity. (210 F. 2d at p. 912.) Actually the court found that the cause of action involved was not in the corporation at all but was in its trustee in bankruptcy and the complaint was therefore dismissed by the District Court for failure to state a claim, and this ruling was affirmed by the Court of Appeals.

So also in the *Ashwander* case, upon which appellant so heavily relies. An examination of that case will show that it did not involve the problem of realignment nor of diversity, but solely the question of whether or not the plaintiff's stockholder had a right to bring the derivative action at all.

Appellant also relies on *Cutting v. Woodward* (9th Cir., 1918), 255 Fed. 633, 635 (Op. Br. pp. 25-26). The facts in that case were not at all like those herein involved, for there (1) the trial court found that the individual defendant and the corporation had engaged in *actual fraud* during a period when the individual defendant had virtual control of the majority of the Board of Directors, and "they were ever ready to do his bidding"; and (2) the defrauding individual defendant continued in control of the corporation and hence the all important element of the independent Board and counsel *intervening* between the period when the wrongful acts were alleged to have been committed and the commencement of the derivative action, was lacking.

We think that the true tests in stockholder's derivative suits are correctly set out in the *Smith v. Sperling* case.

First: A refusal to sue based upon a mere difference of opinion (which is all we have in the case at bar) is *not* sufficient to show "antagonism" or "hostility" (117 Fed. Supp. 802).

Second: The mere fact that the new Board disagrees with the stockholder and hence may in one sense be deemed to be "hostile" or "antagonistic" to the *stockholder,*

so that *his* demand would be "futile," is not controlling. The cause of action involved belongs to the Corporation. Hence, the court quite properly concluded (117 Fed. Supp. 804):

> "Thus in each case the determinative fact is not whether the directors controlling the corporation are antagonistic to the suing stockholder, but whether those in control are shown to be antagonistic to the financial interests of the corporation."

Lastly: The court properly determined that a mere disagreement with the Board of Directors is insufficient to give the stockholder the right to invoke federal jurisdiction, the trial court saying (117 Fed. Supp. 803):

> "A mere argument then, or even a heated debate, between a shareholder and his corporation over the advisability of bringing suit is not a 'controversy' as that term is employed in §2 of Article III of the Constitution. But even if it were, it is not 'the matter in controversy' with respect to which the court is duty-bound to align the parties to the action for the purpose of ascertaining whether requisite diversity of citizenship exists. 28 U. S. C., §1332."

The above-defined rules implement the wise constitutional (U. S. Const., Art III, Sec. 2) and statutory (28 U. S. C., Sec. 1332) prohibition against extension of the federal power to controversies that properly belong in the state courts, and assure that the time and facilities of the already overworked federal courts shall be preserved for the determination of matters where there truly is federal jurisdiction. (See *Healy v. Ratta* (1934), 292 U. S. 263, 54 S. Ct. 700, 78 L. Ed. 1248; *City of*

Indianapolis v. Chase National Bank (1941), 314 U. S. 63, 62 S. Ct. 15, 86 L. Ed. 47.)

For all of which reasons we submit that the tests set out in the *Smith v. Sperling* case were correct and that when applied to the findings of the trial court, the alignment of the Corporation in its true position as plaintiff was necessary and proper.

In closing this Point II, we also respectfully direct this Court's attention to the fact that whatever may be the law in other states, it is well settled in California that where, as here, an independent Board of Directors in the honest exercise of its best judgment determines not to commence or maintain an action, a stockholder may not usurp the discretionary powers of the Board by commencing a derivative action, and that the determination of the matter by the new and independent Board of Directors is an absolute bar to any action by the shareholder.

Findley v. Garrett (1952), 109 Cal. App. 2d 166, 240 P. 2d 421 (Hearing denied by Supreme Court);

Denicke v. Anglo-California National Bank of San Francisco (9th Cir., 1944), 141 F. 2d 285, 287, 288.

Hence, on the facts in the present case, plaintiff actually has not even stated a claim upon which relief could be granted, let alone shown jurisdiction in the federal court.

Conclusion.

The appellant herein holds 400 shares or approximately 1.6% of the 24,521 outstanding shares of appellee corporation representing a total investment to him of $400.00. Although there are numerous other stockholders besides the individual appellees, including two other relatives of the appellant by marriage, no other stockholder has seen fit to join in this costly and unnecessary litigation.

The record may be searched in vain for the slightest evidence of anything indicating a lack of good faith or integrity on the part of the new and independent Board of Directors which went into control over a month prior to the commencement of the within action. The record is equally clear that the Board and the Corporation's counsel cooperated fully with the appellant prior to his bringing the action as well as thereafter, in making available to him the Corporation's records and in examining minutely every claim and charge made by the appellant, despite the fact that although often requested so to do, he failed to supply any evidence to support his charges.

The record also shows clearly that all we have here is a mere difference of opinion between the appellant on the one hand and the new Board of Directors on the other. Such mere difference of opinion, under California law, did not even place the appellant in a position where he could state a claim or cause of action; and even if this Court now were to determine that federal jurisdiction did exist, the action would have to be dismissed for failure to state a claim upon which relief could be granted.

The trial court correctly found that for at least five weeks prior to the commencement of the within action, the Corporation was a completely free agent and not incapacitated from protecting its own interests. Because of such factual situation, the Corporation was properly aligned in its true role as plaintiff, and when so realigned, there is a lack of diversity of citizenship. Hence the action was properly dismissed for lack of federal jurisdiction.

Respectfully submitted,

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